

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:)	In Proceedings
)	Under Chapter 7
DANNY STEPHEN GRAHAM and)	
CINDI SUE GRAHAM,)	
)	No. BK 86-31149
Debtors.)	
THE OLD NATIONAL BANK OF)	
CENTRALIA,)	
)	
Plaintiff,)	
)	
v.)	ADVERSARY NO.
)	87-0049
DANNY STEPHEN GRAHAM and)	
CINDI SUE GRAHAM,)	
)	
Defendants.)	

O R D E R

This matter is before the court on a complaint to determine dischargeability filed by Old National Bank of Centralia ("plaintiff") against debtor Danny Graham. Plaintiff asks that the debt owed it by Danny Graham be held non-dischargeable under §523(a)(2)(A) of the Bankruptcy Code. The relevant facts are as follows:

On August 8, 1985, Graham Well Service executed a note in favor of plaintiff, in the principal sum of \$127,015.21. The note was signed by Graham Well Service's president, Danny Graham, its secretary-treasurer, Cindi Graham, and its vice-president, Herman Graham, Jr. The note was a renewal of a previous note which was then in default.

¹ The complaint also named debtor Cindi Graham, Danny Graham's wife, as a defendant but, after hearing the evidence presented at trial, the Court dismissed the complaint as to her.

As a condition to the renewal of the note, plaintiff required that loan guaranty and subordination agreements be executed by Danny and Cindi Graham, and by Herman and Dorothy Graham, Danny Graham's father and stepmother. Under the terms of the loan guaranty and subordination agreements, the individuals executing these agreements were to become personally liable for the indebtedness these agreements were to become personally liable for the indebtedness owed by Graham Well Service to plaintiff.

Plaintiff placed the burden of obtaining the necessary signatures for the loan guaranty and subordination agreements on Danny. Normally such agreements were signed at the bank, but since Dorothy Graham resided in Lexington, Kentucky, plaintiff allowed her agreement to be signed outside the bank.

Subsequently, Danny presented executed loan guaranty and subordination agreements to plaintiff, including one purportedly executed by Dorothy Graham. As originally presented to plaintiff, Dorothy's agreement lacked the necessary signatures for a witness to Dorothy's signature and for the president of Graham Well Service. On August 13, 1985, plaintiff returned Dorothy's agreement to Danny and requested, in writing, that he sign it as "witness" and as "president." Danny subsequently returned the agreement with his two signatures as plaintiff had requested.

In November 1986, plaintiff received notice of the filing of bankruptcy petitions by Graham Well Service and by Danny and Cindi Graham. In February 1987, plaintiff was informed that the signature of Dorothy Graham on her loan guaranty and subordination agreement was a

forgery. Subsequently, plaintiff received an affidavit from Dorothy Graham stating that the signature on the agreement was not hers.

Also in February 1987, plaintiff liquidated the equipment which it held as collateral on the note. The proceeds from the liquidation did not cover the entire amount still owing on the note, so on March 16, 1987 plaintiff brought the present adversary complaint against Danny Graham.

Plaintiff also alleges that Danny Graham obtained the renewal of the note for Graham Well Service by false pretense, false representation, or actual fraud in that he either forged Dorothy Graham's signature on the agreement before presenting it to plaintiff or he falsely represented to plaintiff that the document contained the signature of Dorothy Graham and that the signature was executed in his presence. Plaintiff further alleges that it relied on Danny's representations, was damaged thereby and, therefore, the debt should be found to be nondischargeable under §523(a)(2)(A).

A debt based on a false representation under §523(a)(2)(A) is excepted from discharge as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt --

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by -

(A) false pretenses, a false representation, or actual fraud....

In order to succeed in an action under §523(a)(2)(A), a creditor must establish that: (1) the debtor made a representation; (2) at the time

the representation was made the debtor either knew it was false or made it with such reckless disregard for the truth as to constitute willful misrepresentation; (3) the representation was made with intent to deceive; (4) the creditor reasonably relied on the representation; and (5) the creditor suffered a loss as a result of the misrepresentation. In re Kinzey, 761 F.2d 421, 423 (7th Cir. 1985); In re Kyriazes, 38 B.R. 353, 354 (Bankr. N.D. Ill. 1983). The party objecting to discharge of a debt has the burden to prove facts establishing these factors by clear and convincing evidence. In re Kinzey, *supra*; Matter of Bogstad, 779 F.2d 370, 372 (7th Cir. 1985); In re Bonnett, 73 B.R. 715, 717 (C.D. Ill. 1987).

In the present case, the parties have concentrated their efforts on addressing two issues: (1) the question of Danny Graham's intention to deceive plaintiff, and (2) whether plaintiff's reliance on Danny's alleged misrepresentation was "reasonable." However, in their haste to address these issues, the parties appear to have overlooked a fundamental prerequisite for nondischargeability under §523(a)(2)(A).

Among the factors a creditor must establish for nondischargeability under §523(a)(2)(A) is that it reasonably relied on the debtor's representation. In this case plaintiff failed to establish that it even relied on Danny's allegedly false representation when it renewed the loan, much less that such reliance was reasonable.

The evidence presented by plaintiff showed that the loan was renewed on August 8, 1985. Robert Kincheloe, plaintiff's assistant vice-president, testified that the signed loan guaranty and subordination agreements were presented by Danny prior to the renewal

of the note, although an exact date was not mentioned. In any case, the only agreement purportedly signed by Dorothy Graham which plaintiff could have had on August 8, 1985 was the one lacking signatures for a "witness" and for the president of Graham Well Service. This was the same agreement plaintiff sent back to Danny on August 13, 1985 for his signature.

Robert Kincheloe testified that plaintiff would not have renewed the loan without Dorothy's signed and witnessed (or otherwise verified) agreement. Yet plaintiff renewed the loan on August 8, 1985, when it only had an unwitnessed signature on Dorothy's agreement. There is no evidence that plaintiff allowed the renewal to take place on August 8, 1985 subject to Danny later signing Dorothy's agreement as a witness. It is worth noting that plaintiff's August 13, 1985 letter to Danny accompanying the returned agreement for his signature made no mention of any contingency on the renewal of the note and, in fact, only asks that the agreement be returned to plaintiff as Danny's earliest convenience.

Plaintiff has failed to sustain its burden of proof that it relied on the allegedly false representation by Danny Graham when it renewed the loan to Graham Well Service on August 8, 1985. Therefore, plaintiff has failed to establish that the debt owed it by Danny Graham should be held nondischargeable under §523(a)(2)(A).

IT IS ORDERED that the complaint to determine dischargeability filed by Old National Bank of Centralia is DENIED.

/s/ Kenneth J. Meyers
U.S. BANKRUPTCY JUDGE

ENTERED: January 28, 1988